COMSAT
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June 12, 1998

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Magalie Salas, Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: In the Matter of Policies and Rules for Alternative Incentive-Based Regulation of COMSAT Corporation, IB Docket No. 98-60

Dear Ms. Salas:

COMSAT Corporation, by its attorneys and pursuant to Section 1.419(b) of the Commission's Rules, files herewith an original and ten copies of the Reply Comments of COMSAT Corporation in the above-referenced proceeding.

An additional copy is enclosed; please date-stamp this copy and return it to the courier. Please refer any questions to the undersigned.

Yours truly,

Bruce A. Henoch

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General Attorney

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FEDERAL COMMUNICATIONS COMMISSION
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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Policies and Rules for Alternative	)	IB Docket No. 98-60
Incentive-Based Regulation of	)	
COMSAT Corporation	)	

REPLY COMMENTS OF COMSAT CORPORATION

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June 12, 1998

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REPLY COMMENTS OF COMSAT CORPORATION

COMSAT Corporation ("COMSAT") hereby files its reply in response to comments filed by AT&T, the Networks, and PanAmSat in the above-captioned proceeding.[1]

Introduction and Summary

As COMSAT demonstrated in its initial comments, the small size of the markets for which COMSAT remains a dominant carrier warrants a simple "incentive-based" regulatory plan to replace the existing rate-of-return regime. The incentive-based plan COMSAT proposed ensures that all users needing satellite capacity for switched-voice, private-line, and occasional-use video service on thin routes will share in the efficiencies realized from deregulation and competition. It also creates true incentives for COMSAT to achieve these efficiencies in a way that guarantees that thin-route users will benefit.

Specifically, COMSAT committed in its comments to lower immediately its digital switched-voice rates on thin routes for low-volume users by four percent upon plan approval, with additional annual reductions of four percent through the year 2002, accompanied by

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[1] AT&T Comments, IB Docket No. 98-60, filed May 29, 1998 ("AT&T"); Comments of ABC, Inc., CBS Corporation, National Broadcasting Company, Inc., and Turner Broadcasting System, Inc., IB Docket No. 98-60, filed May 29, 1998 ("Networks"); Comments of PanAmSat Corporation, IB Docket No. 98-60, filed May 29, 1998 ("PanAmSat").

reassessment at that time.[2] COMSAT's plan also ensures that all tariff reductions initiated on the highly competitive thick routes for private-line and occasional-use video services will be extended equally to thin routes, and that no increases (even for inflation) above the existing market-driven rates will be tariffed. Customers with large traffic volumes and those making extended service commitments will still have a discount option available as well. As explained below, this proposal meets the three criteria established by the Commission for alternative incentive-based regulation and ensures that all of COMSAT's customers will benefit from competitive, transaction rates.[3]

Three other parties, AT&T, the Networks, and PanAmSat, filed comments presenting their own views of incentive regulation for COMSAT.[4] Significantly, none urges retention of rate-of-return regulation for non-competitive markets, and all generally support the Commission's

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[2] As demonstrated below, this figure was not arbitrarily selected, but is roughly equivalent to the efficiencies that other telecommunications companies have historically achieved. However, COMSAT's proposal goes a step further. It requires automatic four percent rate reductions even if COMSAT has been unable to achieve any efficiencies. Under COMSAT's proposal, the four percent annual reduction would be reviewed after five years to determine whether it was still needed. Comments of COMSAT Corporation, IB Docket No. 98-60, filed May 29, 1998, at 10 ("COMSAT Comments").

[3] The Commission stated that the alternative pricing plan should: (1) continue indefinitely; (2) allow users of COMSAT's services on thin routes to benefit from competitive or "transaction" rates; and (3) allow users of COMSAT's services on thin routes to benefit from reduced rates due to increases in efficiency and productivity. *Petition of COMSAT Corp. for Forbearance from Dominant Carrier Regulation and for Reclassification as a Non-Dominant Carrier (Order and Notice of Proposed Rulemaking),* File No. 60-SAT-ISP-97, FCC 98-78 (released Apr. 28, 1998) at ¶ 165 ("Non-Dominance Order" or "Order"). Use of the Commission's proposed criteria was not objected to by any of the commenting parties. *See* AT&T at 4; Networks at 3; PanAmSat at 1.

[4] It is not clear why any of these parties chose to file comments. AT&T already pays the lowest rates possible on all routes through its inter-carrier contracts with COMSAT, while the four television networks combined utilized only $59,000 worth of thin-route occasional use video service in 1997. Additionally, PanAmSat is COMSAT's direct competitor, and would thus not seem to have an interest in seeing a reduction in COMSAT's rates.

proposal to allow COMSAT to utilize an alternative plan for the thin-route segment of COMSAT's business. However, rather than submitting proposals for a simple incentive-based plan as the Commission recommended, they urge the agency to design and implement a cumbersome price cap regime like that adopted for multi-billion dollar local exchange carriers ("LECs"). Use of that approach for markets constituting only $19 million in total revenue for COMSAT -- which would be akin to using a sledgehammer to kill a gnat -- is not warranted here. Better alternatives exist to ensure that COMSAT's thin-route customers enjoy the benefits of competitive thick-route pricing.

Discussion

A. COMSAT's Plan for Switched-Voice Services

As COMSAT discussed in its comments, the three largest carriers -- who pay the same rates for service on all routes under their FCC-filed inter-carrier contracts with COMSAT -- account for more than 80 percent of the switched-voice traffic on thin routes.[5] This means that only about 500 International Digital Route ("IDR") circuits are currently used to provide switched-voice service to the 63 thin-route countries to carriers who do not qualify for volume discounts under contract. COMSAT's proposal is targeted directly to these thin-route users, and will lower thin-route IDR tariff rates by four percent immediately, and four percent annually through 2002. It is a highly efficient and effective solution that will ensure that these low-volume

[5] COMSAT Comments at 6.

customers enjoy the transaction rates derived from the most competitive routes.[6]

AT&T's suggestion that the Commission implement a plan modeled after the price cap regime applicable to the largest LECs, including the annual calculation of an appropriate X-factor, would be regulatory overkill.[7] The Commission itself never suggested that such a price cap model would be appropriate here; its discussion of productivity factors was in the context of its rejection of a price cap regime like those applicable to the largest carriers.

As the Commission is well aware, the current price cap structure for LECs is complicated and took years to develop. The productivity factor for LECs alone has taken over six years to devise, and all of the reconsideration petitions and appeals of the latest Commission decision on this matter are yet to be resolved.[8] The current X-factor was developed based on previously available productivity studies of the LEC industry, and thousands of pages of documents were filed by numerous interested parties to develop a record upon which the Commission could base its decision. Reams of econometric data and special studies underlay the Commission's efforts. The remaining aspects of the LEC price cap scheme also entailed thousands of pages of comments

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[6] Likewise, COMSAT's International Business Service ("IBS") pricing proposal described in its comments meets all of the Commission's concerns, particularly given the 8-10 percent IBS rate reductions that customers on all routes obtained less than a year ago. *See* COMSAT Comments at 11-12. Significantly, no party filing comments expressed any concerns about COMSAT's IBS pricing.

[7] AT&T at 5.

[8] *See, e.g., Policy and Rules Concerning Rates for Dominant Carriers,* CC Docket No. 87-313, 5 FCC Rcd 6786 (1990), *Erratum,* 5 FCC Rcd 7664 (1990), *modified on recon.*, 6 FCC Rcd 2637 (1991) , *aff'd sub nom. National Rural Telecom. Ass'n v. FCC*, 988 F.2d 174 (D.C. Cir. 1993); *Price Cap Performance Review for Local Exchange Carriers,* CC Docket No. 94-1, 10 FCC Rcd 8961 (1995), *aff'd sub nom. Bell Atlantic Tel. Cos. v. FCC,* 79 F.3d 1195 (D.C. Cir. 1996); *Price Cap Performance Review for Local Exchange Carriers*, CC Docket Nos. 94-1 and 96-262, 12 FCC Rcd 16642 (1997).

by interested parties and multiple Commission decisions on a number of intricate details regarding the development of formulae and procedures for implementing LEC price caps.

While this complex process might be warranted for LECs that generate tens of billions of dollars in revenue annually, COMSAT's provision of low-volume, thin-route IDR traffic does not come close to justifying the huge expenditure of time and effort that would be required to develop, implement, and maintain a similar regime. Indeed, in COMSAT's case, the cost to undertake such a regulatory regime would consume much of the efficiencies that otherwise can be made available to low-volume, thin-route users. In short, the costs would far outweigh the benefits given the small size of the business at issue.

This is particularly true in light of COMSAT's proposal to implement an *immediate* four percent rate cut for thin-route IDR traffic, with four percent reductions annually through 2002, regardless of variable external cost factors, such as inflation. This rate reduction guarantees that COMSAT's thin-route IDR customers will see absolute rate reductions as soon as the Commission approves COMSAT's proposal. Even if the Commission were to engage in a complex analysis of the type suggested by AT&T and eventually derive a productivity factor based on COMSAT-specific information of greater than four percent, inflation and other offsetting factors would likely result in the customer realizing a rate reduction *less* than or equal to that proposed by COMSAT in its comments.[9]

Under the COMSAT proposal, the company alone will assume the real financial risks if it cannot continually increase its efficiency and productivity, because it is committing in advance to a five-year program of actual rate reductions for low-volume users. In this regard, AT&T stated in its comments that there should be no guarantee that COMSAT will recover all of its costs.[10] COMSAT's proposal for annual four percent rate reductions effectively does that, because it means that COMSAT will take all of the risk.[11]

B. COMSAT's Plan for Occasional-Use Video Services

As COMSAT discussed in its comments, demand for occasional-use video service on thin routes -- which generated less than $850,000 in total revenues in 1997 -- is extraordinarily low.[12]

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[9] Of course, deriving the appropriate productivity factor for COMSAT would necessarily be a very complex undertaking since, as the Networks note, there have been no productivity growth studies specific to the satellite industry. Networks at 5. Additionally, unlike the LECs, COMSAT does not have control over many of its costs -- including purchasing, satellite deployment, and other cost-related system management decisions -- since these are matters under the control of INTELSAT rather than COMSAT. In order to increase productivity, COMSAT is limited to finding efficiencies in the areas not affected by the cooperative decision-making nature of INTELSAT. *See* COMSAT Comments at 9.

[10] AT&T at 5.

[11] AT&T also states that any X-factor imposed by the Commission on COMSAT "should pass through ongoing unit cost reductions to consumers." AT&T at 4-5. This proposal should not be taken seriously unless, at a minimum, AT&T is itself committed to passing along to its customers any savings that it realizes through COMSAT's rate reductions. However, this does not appear to be AT&T's practice as far as its international rates are concerned. While COMSAT has lowered its space segment rates to AT&T since 1992, AT&T has generally *increased* its rates for basic Dial 1 outbound services. *See, e.g.*, "Notice to AT&T Long Distance Customers" (advertisement), *The Washington Post*, Jan. 23, 1998 (notifying AT&T customers of no less than *eleven* separate rate increases for international services)

[12] COMSAT Comments at 12.

In addition, contrary to statements made in the Order, COMSAT has tariffed two occasional-use video rate reductions since 1995.[13] As a result, a complex and cumbersome price cap scheme for occasional-use video is not necessary, and the Commission can accomplish its goal of ensuring that COMSAT's thin-route occasional-use video customers pay competitive rates by simply requiring that COMSAT cap its prices at the current, market-driven transaction rates, and pledge to offer the same general tariff rates to customers on thin routes as provided to customers on the competitive thick routes.[14] Like COMSAT's proposal for IDR rates, this proposal satisfies all of the criteria specified in the Order.[15]

COMSAT accepts the Networks' proposal that the pricing plan shall remain in place for an indefinite period and that it will be necessary to reexamine the status of thin routes as conditions warrant.[16] However, the Networks -- like AT&T in the switched-voice context -- have suggested a highly cumbersome federal regulatory regime for a market of less than $850,000. In fact, the Networks' proposal is all the more baffling and indefensible given that the aggregate thin-route occasional-use traffic of the four television networks filing comments (ABC, NBC, CBS, and Turner) accounted for approximately $59,000 in revenues in 1997, or just seven percent of all of COMSAT's thin-route occasional-use video revenues.

As with IDR rates, developing a price cap scheme for the small size of this market,

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[13] *Id.* at 13.

[14] It bears repeating that COMSAT's rates are uniform; thus the rates charged to thin-route customers are the *same transaction rates* that are charged to customers on the competitive routes.

[15] *Id.* at 13.

[16] Networks at 4-5.

including an appropriate productivity factor, is neither necessary nor desirable. This is especially true in light of the Networks' own acknowledgment that productivity growth studies for the satellite industry currently do not exist,[17] and combined with the fact that COMSAT does not control many of its costs. Developing a price cap regime would require the dedication of significant resources from both COMSAT and the Commission, and the minimal amount of traffic in question simply does not justify such an expenditure COMSAT's proposal to cap its current market-driven rates, and to apply any competitive thick-route rate reductions to thin-route customers, is sufficient to satisfy fully the Commission's goals.

In addition, the assumptions upon which the Networks rest their argument for imposition of a price cap regime on COMSAT are not correct.[18] For example, the Networks state that "[w]ith the increasing implementation of digital compression technologies in the satellite industry which allows the derivation of additional channels from the same bandwidth, productivity gains can be expected to exceed the 6.5% per year x-factor adjustment the Commission adopted last year for the local exchange carriers."[19] First, this is simply inapplicable to much of COMSAT's occasional-use traffic. There is still a large amount of analog video traffic, particularly in developing countries and in other places where earth stations do not have digital capability, and

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[17] Networks at 5.

[18] COMSAT notes, as it did with regard to IDR rates, that the Commission has not proposed to implement a price cap scheme for occasional-use video.

[19] Networks at 6.

the volume of this traffic is expected to remain relatively steady.[20] Second, digital compression technology applied to multi-user occasional-use service may actually *decrease* the space segment supplier's cost efficiency because it uses less space segment capacity and may reduce transponder fill factors, as well as increase the cost of network management. Finally, efficiencies afforded customers by compression technology are already reflected in the narrower bandwidth offerings COMSAT has made available in its tariff on all routes.

Furthermore, as the Networks themselves recognize, occasional-use video is by its very nature a high-cost service, in which efficiencies are very difficult to achieve. While the Networks state that it is inevitable that productivity will necessarily increase, they also concede that,

> by definition, occasional service, involves only extremely short-term commitments, and ones that are unpredictable in terms of whether, if at all, needs for service may arise again in the same place. <u>The nature of such short-term commitments acts as a disincentive for carriers to invest the resources and time necessary to develop competitive alternatives</u>.[21]

As the Networks are well aware, these disincentives apply as strongly to COMSAT as they do to any other company, yet the Networks fail to justify their contradictory conclusion that COMSAT's provision of occasional-use video will necessarily experience rapid and continuous increases in efficiencies over time.

The Networks also contend that occasional-use video should be placed in a separate price cap "basket" in order to prevent COMSAT from cross-subsidizing other services with occasional-

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[20] The same satellites are used for analog and digital service. The ground segment determines whether the signals are analog or digital. The large amount of continuing analog traffic is due to <u>customers</u> continuing to use analog ground equipment.

[21] *Compare* Networks at 9 (emphasis added) *with id.* at 6.

use revenues.[22] Baskets have been used only where there is a significant likelihood that services with different competitive circumstances could lead to incentives to shift costs among services.[23] Such a concern is completely absent here and would needlessly increase the complexity of the Commission's regulation of COMSAT's thin-route rates. As mentioned above, the total amount of revenue derived from thin-route occasional-use video services was less than $850,000 in 1997. Given this minuscule amount of revenue from thin-route occasional-use video, there simply is no incentive or ability for COMSAT to engage in cross subsidization of IDR traffic, where the dollar value of the service is much greater.

Furthermore, even if the amount of revenue in question were not so diminutive, this issue has already been discussed and dismissed by the Commission. The Order found that "its decision to maintain the existing cost allocation and accounting requirements . . . provides sufficient oversight of COMSAT that we could take action if it appears that COMSAT's customers for switched-voice, private-line and occasional-use video service to non-competitive markets, are bearing costs not properly attributable to service in these markets."[24] The Networks did not contest this finding, and they fail to provide any information that would suggest that the Commission's conclusion need be modified in any way.

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[22] *Id.* at 7.

[23] *See, e.g.*, *In re Motion of AT&T to be Reclassified as a Non-Dominant Carrier,* 11 FCC Rcd 3271, 3279 (1995) (services subject to price cap regulation divided into baskets "to avoid cross-subsidies between groups of services that we recognized might be subject to differing levels of competition"). Note that the Networks' proposal assumes that there are different competitive characteristics in the IDR and occasional-use markets -- but that the record contains no evidence to support this assumption.

[24] Order at ¶ 172.

C. Concerns Regarding "Predatory Pricing" Are Unfounded

PanAmSat states in its comments that the Commission must take action to ensure that COMSAT is not able to engage in "predatory pricing."[25] What PanAmSat really fears is the price competition COMSAT can now implement with the elimination of many regulatory costs, such as structural separation. In any case, PanAmSat's concerns ignore the fact that predatory pricing has been recognized by the courts as a business strategy that would be extremely difficult to implement successfully.[26] The Commission too has found predatory pricing claims to be suspect.[27] Indeed, given the Commission's "continuing skepticism about the potential for an incumbent LEC to engage successfully in predatory pricing" in the domestic local exchange market, where carrier market shares exceed 95 percent, it should be clear that the potential for COMSAT to engage in such activity in the U.S. international marketplace is nil.[28]

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[25] PanAmSat at 2.

[26] *See, e.g., Matsushita Elec. Ind. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 594 (1986) (economic realities make predatory pricing schemes self-deterring). The Supreme Court has stated that, for a predatory pricing claim to be sustained, there must be both long term below-cost pricing *and* the likelihood and expectation that the defendant would be able to subsequently raise prices high enough above a competitive level and for a long enough period that it would be able to recoup all of the money lost on the predation. Without such an expectation of recoupment, "predatory pricing" actually benefits competition by lowering prices in the marketplace. *See Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 225 (1993) ("Brooke Group").

[27] *See PanAmSat Corp. v. COMSAT Corp. -- COMSAT World Systems*, 12 FCC Rcd 6952, 6958 (1997); *Access Charge Reform*, 11 FCC Rcd 21354, 21487-88 (1996).

[28] *Access Charge Reform,* 11 FCC Rcd at 21488.

In any case, it would be impossible for such a claim to be sustained with regard to COMSAT's thin-route pricing proposal. The thin-route markets, as defined, are shrinking, and COMSAT has committed not to raise rates there. A valid predatory pricing scheme requires both below-cost pricing *and* the expectation that losses will be more than recouped later through price hikes after competitors are driven from the business.[29] Because COMSAT will not raise thin-route rates, the returns generated on these routes would not provide a basis for a predatory cross-subsidy, much less a foundation from which to drive others out of business.

Conclusion

For the reasons discussed herein and in COMSAT's comments, the Commission should adopt COMSAT's incentive-based regulatory proposals for the three thin-route services in question. Because the amount of thin-route traffic is minimal, there is no need for the Commission to impose here a complicated price cap/productivity factor structure similar to the schemes governing the rates of the large local exchange carriers. The complexity of such a regulatory scheme is simply inappropriate given the magnitude of the business area being regulated. COMSAT's proposals, on the other hand, will be easy to implement and administer. They will ensure prompt and predictable rate reductions for thin-route low-volume IDR customers and guarantee that COMSAT's thin-route occasional-use and IBS customers (who

[29] *Brooke Group,* 509 U.S. at 225.

have enjoyed recent rate reductions) will enjoy the benefits of all future rate reductions made on the most competitive routes.

Respectfully submitted,

COMSAT CORPORATION

By: ______________________

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June 12, 1998

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing Reply Comments of COMSAT Corporation was served by U.S. mail, postage prepaid, this 12th day of June 1998 on the following:

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